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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

William F. Caton
Acting Secretary
Federal Communications Commission
Washington, D.C. 20554

Re: Ex Parte
CC Docket No. 94-1
Further Notice of Proposed Rulemaking
LEC Price Cap Performance Review

Dear Mr. Caton:

MCI sent the attached letter to Richard Metzger, concerning its views on the issues in the above-captioned proceeding.

An original and two copies of this notice have been submitted to your office in conformance with Section 1.1206(a)(1) of the Commission's rules.

Sincerely,

Chris Frentrup

Chris Frentrup
MCI Telecommunications Corp.
Federal Regulatory Affairs

cc: Richard Metzger
Geraldine Matise
Anna Gomez

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Donald F. Evans
Vice President
Federal Regulatory Affairs

May 9, 1995

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Richard Metzger
Deputy Chief
Common Carrier Bureau
Federal Communications Commission
Washington, D.C. 20554

Re: EX PARTE In Further Notice of Proposed Rulemaking, LEC Price Cap Performance Review, CC Docket No. 94-1

Dear Mr. Metzger:

This letter is in response to your request for MCI's views on the issues the Commission has deferred for consideration in the Further Notice in the LEC Price Cap Performance Review. Since the Commission has provided extensive direction in the LEC Price Cap Performance Review Order concerning the issues to be explored in the Notice, MCI does not seek to add new issues to the further proceeding. MCI asks only that those issues that have been identified be raised in a neutral manner. In furtherance of that request, MCI suggests that the Commission consider including the following questions and concerns in the Further Notice, which MCI believes will permit a full airing of the benefits and potential pitfalls of the Commission's tentative conclusions.

Total Factor Productivity -- Measuring Input Costs

One of the key issues that must be addressed in deciding to employ a total factor productivity approach is the problem of administering a regulatory data collection of input cost factors.

1. As part of the determination of input costs, what is the appropriate depreciation rate to use? Who decides when this changes? Should the Commission use the financial depreciation rate advocated by USTA, or should it use the depreciation rate prescribed under the Commission's current depreciation process? What legal obstacles under Section 220 of the Communications Act exist to using a depreciation rate that is not established by the Commission?

2. Is TFP affected by the level of the depreciation rate chosen, or only by changes in the rate? That is, if both the financial and regulatory depreciation rates are changing by the same amount each year, will the TFP be the same regardless of the depreciation rate method chosen?

3. What are the various methods that the Commission could use to determine LEC cost of capital?

4. What data used in USTA's TFP study can be referenced from ARMIS or some other available public source? What are those references, and what inputs will require a new data collection?
What are the costs of new data collection?

5. What mechanisms are available to the Commission to ensure that the input cost data employed in the calculation of TFP are reasonably accurate and comply with Commission rules? What auditing or other enforcement processes might be necessary to ensure the accuracy of the data?

Total Factor Productivity -- Effect on Index Formula

As the Commission has previously recognized, the size of the productivity offset is directly related to the structure of the index formula and its components. For example, a "per minute" formula for common line requires a much higher productivity offset to produce the same result as a "per line" common line formula. If the theory and basis for the productivity offset is revised to use a total factor productivity approach, consideration must be given to how that change effects the index formula.

1. Does a productivity offset based on total factor productivity require a revision to existing price cap formulas? Does a TFP approach require the use of a per minute formula for all baskets? If it does, what is the equivalent productivity offset to the existing "base" offset of 4 percent?

2. If it is true that the production function for interstate access is non-separable from intrastate services, as the Commission stated in the LEC Price Cap Performance Review Order, then the Commission must also assume that growth in inputs would be the same whether the LEC offered only intrastate services or both intrastate and interstate services. Based on the data filed by USTA, growth of total company output and TFP appears to be 3-3.5 percent less than the growth in interstate output and TFP, a difference which amounts to approximately $600 million per year. What evidence is there to support the assumption that growth in input costs differs in the two jurisdictions? What factors or reasons should the

Commission rely on in choosing between an interstate TFP and a total company TFP?

Use of a Rolling Average to Update Index Levels

1. Is there sufficient variability year to year in LEC productivity to justify the additional administrative burden of imposing an annual update of TFP?

2. Compared to a "rolling average" approach to ensuring that the price cap index establishes a reasonable productivity challenge for all price cap LECs, are there approaches other than the sharing method that would ensure the index formula establishes reasonable rates for all carriers?

3. How many years should be included in a rolling average?

4. Should the Commission preclude a LEC from revising previous years' data to more accurately reflect that year's performance? If amendments to previous years' data is permitted, what processes can the Commission utilize to ensure that data revisions are accurate, and have not been made in order to produce an outcome favorable to the LEC? What remedy exists for ratepayers if a subsequent proceeding determines that data revisions were introduced that resulted in rates higher than they would have otherwise been? If the Commission desires to preclude revision of historical years' data, does it have the legal authority to do so?

Elimination of Sharing

The Commission has tentatively found that elimination of sharing requirements would be in the public interest because it would provide maximum incentives for price cap LECs to become more productive. The Commission has said it would prefer to look at other vehicles (e.g., use of a rolling average productivity) to solve the problem of individual "outliers" or the problem of how to adjust for longer-run variations in productivity.

The sharing mechanism serves another function, which the Commission has in the past acknowledged -- to remedy very high earnings. MCI argues that the Commission should include this role of sharing in its evaluation of the sharing mechanism. MCI further advocates that the Commission explicitly take comment on the extent to which very high earnings can be attributed to productivity gains, or whether high earnings are simply a manifestation of monopoly pricing. MCI also believes that, if sharing is eliminated as a ratepayer protection mechanism, the Commission must provide some other vehicle within price caps to drive rates to economic cost, e.g. a larger productivity offset or upfront rate cuts.

Transition to Competition

The Notice mentions several possible changes to LEC regulation that may become necessary as competition develops in the future. In addition to posing the obvious issues about how the Commission should measure the development of competition and determine the corresponding degree of regulatory flexibility to use, MCI also urges the Commission to solicit comment on whether LEC pricing flexibility must also depend upon the existence of a competitive framework for interstate competition. For example, while the Expanded Interconnection proceeding compels LECs to provide interconnection services for a fee to new entrants, basic interconnection is but one of a multitude of issues that must be resolved in order to provide the framework that would allow a fully competitive market to develop. Number portability, mutual compensation, and the future of universal service subsidies are examples of issues that must be resolved before the Commission can hope to declare a market effectively competitive.

MCI is available to discuss these issues with you at your convenience.

Sincerely,

Donald F. Evans

cc: Richard Metzger
Geraldine Matise